Service Date: December 10, 1992

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

* * * * *

IN THE MATTER OF The Application by the MONTANA POWER COMPANY for Authority to Increase Rates for Natural Gas and Electric Service.	))))	UTILITY DIVISION DOCKET NO. 90.6.39 ORDER NO. 5484z

Final Order on Reserved Issues

APPEARANCES

FOR THE APPLICANT:
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FOR THE COMMISSION:
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BEFORE:
DANNY OBERG, Chairman
WALLACE W. "WALLY" MERCER, Vice Chairman
BOB ANDERSON, Commissioner
JOHN B. DRISCOLL, Commissioner
TED MACY, Commissioner

FINDINGS OF FACT: FIBER OPTIC GROUND (FOG) WIRE

Background

1. On June 16, 1989, Montana Power Company (MPC or Applicant) entered into the Montana Optical Ground Wire System Agreement with AT&T and Telecommunications Resources Inc. (TRI), an affiliated company under Entech. On the same day, MPC and TRI executed a second agreement, the Optical Ground Wire Project Agreement. (Agreements in MPC response to MCC Data Request No. 127) The two agreements relate to the deployment, ownership, operation and maintenance of the FOG Wire project. Additionally, the agreements define the roles, responsibilities, financial

costs and rewards for each of these participants in the FOG Wire project. The project was substantially completed in July, 1990.

2. On January 28, 1991, the Montana Public Service Commission (Commission or PSC) issued Order No. 5484h which identified several new issues including the FOG Wire issue. The Commission invited all Parties in the Docket to comment on whether the terms of the agreements were reasonable and provided the electric utility with fair compensation and safeguards for the use of its properties and employees. The Commission also asked the Parties to comment on whether the revenues and costs associated with the FOG Wire project should be reflected in the determination of revenue requirements in Docket No. 90.6.39.

3. In February 1991, MPC filed supplemental testimony on the FOG Wire issue. (RPG, pp. 13-19) Mr. Robert Gannon, MPC witness, explained that TRI owns the FOG Wire and leases it to AT&T. He stated that MPC is responsible for providing transmission structures, TRI is responsible for the operation and maintenance of the FOG Wire. Mr. Gannon testified that MPC would receive a pole attachment fee from TRI. The fee was paid in two forms: (1) $412,693 in cash (this cash payment represents $600,000 less $187,307 in costs to upgrade the transmission system) and (2) the use of 48 microwave channels. He stated that the $600,000 was calculated using $6.50 per pole, or approximately two times the rate MPC charges for cable TV attachments. Further, he indicated that the use of the 48 microwave channels allowed the Company to defer until 1995 an upgrade to its own microwave system. MPC maintained that the deferral represented a $2 million savings to ratepayers. Additionally, Mr. Gannon stated that MPC will receive 20 percent reimbursement from TRI for regular maintenance that MPC performs on the affected transmission lines. He also maintained that the utility received, at no cost, a thorough inspection of the transmission system used by the FOG Wire project. (Prefiled supplemental, February, 1991, RPG, pp. 14-17)

4. Mr. Gannon explained that TRI was appropriately involved in the project because the electric utility is not in the telecommunications business. MPC was not interested in taking on the responsibilities and risks associated with laying

the cable, maintaining it or repairing or replacing it. (Prefiled supplemental, February, 1991, RPG, p. 18)

5. Mr. Gannon made no specific recommendation as to the ratemaking treatment in this proceeding of the impacts on revenues and expenses.

6. On March 19, 1991, MCC filed supplemental testimony on the FOG Wire issue. (AEC, pp. 18-23) Mr. Clark testified that it was impossible to know at that time whether MPC had been fairly compensated. Mr. Clark believed that the utility should attempt to maximize revenues from such types of transactions so as to reduce costs to ratepayers. (Prefiled supplemental, March 19, 1991, AEC, pp. 18-19)

7. Mr. Clark noted a discrepancy in the actual amount of the cost to upgrade the transmission system. Nonetheless, he stated that "regardless of the actual amount, however, the payment received from TRI should be regarded as $600,000." (Prefiled supplemental, March 19, 1991, AEC, pp. 20-21)

8. Mr. Clark's testimony included alternatives for treating the payment from TRI for ratemaking purposes. The options before the Commission include (1) amortizing the payment over the twenty-five year FOG Wire contract and reducing rate base for the unamortized balance of the payment as customer contributed capital; (2) using a shorter, five year amortization; or (3) ignoring the present value calculation and the up-front payment, and instead crediting the revenue requirement by the annual pole rental fee adjusted for inflation. Mr. Clark stated that it should go without saying that the annual reimbursement that the electric utility receives from TRI for 20 percent of the operation and maintenance (O&M) costs on the related facilities should be credited to the ratepayers. (Prefiled supplemental, March 19, 1991, AEC, p. 21)

9. Mr. Clark indicated that there was insufficient information relative to the maximum amount MPC could have charged and still allowed the project to continue. He recommended that revenues and costs be initially set on the basis of MPC's numbers, but that this issue be explicitly reserved for future review.

10. On April 11, 1991, MPC filed supplemental rebuttal

testimony. (TJM, p. 2) Mr. Matosich agreed with MCC witness Mr. Clark that the payment received from TRI should be regarded as $600,000 for ratemaking and that the 20 percent maintenance fee should be credited to ratepayers.

11. The initial hearing was held in April, 1991. In the hearing, when asked if MPC had done an independent determination of the value of its rights-of-way, Mr. Gannon indicated the Company had not done so. Mr. Gannon also discussed MPC's rights-of-way along its transmission system:

> We had rights-of-way easements of three types ... one of them was very clear, it granted a right to add telecommunications equipment. Another kind did not have any right whatsoever for telecommunications equipment ... and there was another type of easement that was in between.
>
> We, in the utility, weren't comfortable with the easement situation that I have just explained and said, AT&T, TRI, you get whatever additional rights-of-way you might need, and that was one of, what I thought, the very severe risks that they had ... We basically said, If we have the rights-of-way that authorizes what you want to do, then fine; but if we don't, then you better get it ... They paid a lot of money for it. (Tr. pp. 74-75)

12. On July 17, 1991, the Commission issued Order No. 5484k. The Commission found both MPC and MCC supported reflecting the $600,000 FOG Wire revenues over either the 25-year life of the contract or alternatively over a shorter 5-year period, with the unreflected balance as rate base offset. The Commission found a 5-year amortization to be appropriate, resulting in increased revenues of $120,000 with an average rate base offset for the amortization period of $183,967. (FOF 254, Order No. 5484k) The Commission agreed with Mr. Clark that there was insufficient information on the record to draw final conclusions about the reasonableness of MPC's compensation. This

issue was to be visited in MPC's next general electric rate case. At that time, the Company would have been required to demonstrate that reasonable compensation was received. (FOF 255, Order No. 5484k)

13. On July 30, 1991, MCC filed a Motion for Reconsideration of Order No. 5484k. MCC stated that in FOF 255, Order No. 5484k the Commission had determined that this issue would be revisited in MPC's next general electric rate case. MCC argued that in FOF 206, Order No. 5484k, the Commission made the $650,000 "benefit" from the Reciprocal Sharing Arrangement (RSA) interim in nature. MCC requested that the Commission afford the same interim treatment to the FOG Wire revenues.

14. On August 12, 1991, MPC filed a response to MCC's Motion for Reconsideration, disagreeing that interim treatment was proper. MPC stated that the record contained no support for such treatment nor did MCC's motion. MPC contended that it was entitled to a final order and that there was no basis to create uncertainty about this issue until a final order in the next rate case.

15. On November 7, 1991, the Commission issued Order on Motions for Reconsideration, Order No. 5484p. The Commission found that the record established in this case did not convince the Commission that the revenues received by MPC in this affiliated interest transaction were sufficiently compensatory. (FOF 67, Order No. 5484p) Without interim treatment, customers were potentially disadvantaged due to the loss in purchasing power associated with the time value of money. The Commission determined that interest would be accrued at 12.1 percent if higher FOG Wire revenues were determined to be appropriate. (FOF 69, Order No. 5484p) MCC's Motion for Reconsideration was granted. (Id.) In recognition of MPC's concerns regarding a definite end to the uncertainty, the Commission reserved the FOG Wire issue to be addressed in the same manner and at the same time as the RSA issue. MPC was invited to respond by January 30, 1992, to the general question of whether adequate compensation was received in the FOG Wire transaction. (FOF 70, Order No. 5484p)

MPC Request for Final Order

16. On January 31, 1992, MPC filed a request for a final order on the FOG Wire issue. MPC stated that "the value received [for the FOG Wire project] is considerable and sufficient especially when one considers that the compensation is for the use of the structures only and that MPC had none of the costs or risks involved in the project." MPC noted that four types of compensation were received by the utility:

Pole Rental Fee	$600,000
Maintenance Expense	$480,000
48 Microwave Channels	$2,000,000
Transmission Inspection	$250,000
Total MPC Compensation	$3,330,000

Risks MPC identified as belonging to TRI included: failure of the fiber before its estimated life; the possibility of obsolescence; operation and maintenance; and obtaining adequate rights-of-way. (Exh. MPC-3, pp. 1-9)

17. MPC stated that the Utility did not conduct an independent analysis of the value of its rights-of-way for the FOG Wire project. The reasons given by MPC for this failure were that it would be difficult to determine the value of the rights-of-way because various amounts were paid to various landowners at different times over the last 80 years. MPC stated that there was a substantial risk to TRI because TRI was obligated to perfect the rights-of-way with many landowners to allow an easement for telecommunications. MPC stated that TRI assumed the ongoing risks and asked that the ratemaking treatment presently accorded the FOG Wire project be made final. (Exh. MPC-3, pp. 10 and 11)

18. On January 31, 1992, MPC also filed the proprietary testimony an a worksheet of Mr. Michael J. Meldahl. Mr. Meldahl discussed four main points: (1) TRI's profit on the construction of the FOG Wire project; (2) use of TRI's facilities for this project (and not MPC's); (3) TRI's substantial responsibilities under the contract with AT&T; and (4) the significant value of 48 digital communication channels in the marketplace. (Exh. MPC-5)

MCC Testimony

19. On May 18, 1992, MCC filed testimony on the FOG Wire issue, changing witnesses from Al Clark to Allen G. Buckalew. Mr. Buckalew stated that MPC leased to TRI certain rights

pertaining to telecommunications network deployment along MPC's transmission lines. TRI constructed a FOG Wire communication system over MPC's transmission facilities and rights-of-way.

20. Mr. Buckalew stated that in consideration for the installation, operation and maintenance of this system AT&T agreed to pay TRI approximately $__________ initially, plus about $183,000 annually. Total construction costs were about $__________ leaving gross initial profits of about $__________. [NOTE: The Commission observed that Mr. Buckalew did not include all costs incurred by TRI in arriving at gross initial profits.] Those profits were divided between TRI, Alcoa (who supplied the aluminum clad FOG Wire) and an individual (John Warta) who was involved in putting the deal together. TRI also agreed to pay MPC a one-time pole attachment fee of $472,694 (net of pole construction cost reimbursement) plus the lesser of $57,854 or 20 percent of the annual O&M costs of the associated transmission line facilities. (Exhs. MCC-1, pp. 4 and 5; MCC-2, pp. 4 and 5) Mr. Buckalew stated:

> It is very clear that MPC has used TRI as an unregulated "vehicle" in which to realize and record a large profit windfall in excess of the Company's cost of capital and authorized rate of return. Apparently, MPC intends to retain this windfall for its stockholders rather than using the proceeds to provide traditional revenue offsets for its utility ratepayers. (Exh. MCC-1, pp. 5-6)

21. Mr. Buckalew did not agree that MPC's treatment of the FOG Wire project was reasonable. He stated that without the electric utility's rights-of-way and transmission structures, the project would not have been possible. MPC's electric customers have paid for the transmission facilities and the rights-of-way, yet MPC seeks to remove the profits from this project.
Mr. Buckalew stated that this type of exploitation is unfair to the utility's customers while creating an excess profit windfall, over and above the allowed rate of return, for the shareholders. (Exh. MCC-1, p. 6)

22. Mr. Buckalew disputed TRI's claim that it made only a ____ percent rate of return. Mr. Buckalew stated that the ____ percent return was calculated by taking the net income and

dividing that into total revenues, which he found absurd. He noted that a rate of return is related to rate base or investment. (Exhs. MCC-1, p. 7; MCC-2, p. 7)

23. Mr. Buckalew disputed MPC's claim that the present value of the deal to MPC was $3.33 million. Mr. Buckalew questioned how MPC could place a $480,000 value on O&M costs without knowing how much the FOG Wire would cost to maintain. He testified that the present value of the inspection is not a real value because MPC inspects its own facilities and further, the inspection was not absolutely necessary. (See MPC response to PSC Data Request No. 623.) Mr. Buckalew challenged MPC's claim that the present value of the 48 microwave channels was $2.3 million ($2.0 million). "TRI may be equating the channels to the capital cost of a microwave system but 48 channels do not cost $300,000 annually if leased from a communications supplier." (Exh. MCC-1, p. 15) According to Mr. Buckalew, the charge for using 48 circuits full time for 30,000 miles would be less than $250,000 a year. Furthermore, communication costs have declined and are expected to continue to decline in the future. Mr. Buckalew noted that the analysis assumed current use of all 48 channels which is not correct because these channels would serve MPC's needs for several years into the future. (Exh. MPC-1, p. 7-16) Mr. Buckalew stated:

> Regardless of the claimed value, the proper regulatory treatment is for MPC, if it uses an affiliate, like TRI, for communications services to pay TRI the market rate. (Exh. MCC-1, p. 16)

24. Mr. Buckalew contended that even if MCC agreed with the $3.33 million present value that MPC claims to have received, MPC still would not have received adequate compensation since the deal was worth about twice as much. (Exh. MCC-1, p. 7)

25. Mr. Buckalew was concerned that ratepayers may be forced to pick up the tab for any serious unforeseen problems with the FOG Wire over the next 20 years. He was also concerned that any problems with the FOG Wire represented increased risk to the Utility since the FOG Wire itself is an integral part of utility service, it protects the transmission lines.
Mr. Buckalew noted that the Utility takes on additional risk with

the FOG Wire project since the O&M payment is capped. In addition, Mr. Buckalew contended that TRI was attempting to transfer any advantage that MPC had as a competitive communications supplier to the stockholders instead of ratepayers. Mr. Buckalew stated that some other electric utilities are using these advantages to help lower electric costs. (Exh. MCC-1, pp. 10 and 11)

26. Mr. Buckalew gave an example of an electric utility that fully credited the benefits of a similar transaction to the ratepayers.

> Pacific Power & Light has an agreement with MCI to do virtually the same thing for MCI -- that is, using FOG Wire as both a static wire and as a fiber optic communications carrier. The difference is that PP&L customers, not an unregulated corporate affiliate, will reap the profits, which will help lower costs to electric customers. (Exh. MCC-1, p. 11)

MCC's PROPOSED RECOMMENDATIONS

MCC Option 1

27. MPC should receive an initial lump sum payment from TRI of $_________ (used to reduce rate base) plus $165,000 annually for 25 years. This option would permit TRI and its partners (Alcoa and Warta) to retain $_________ (as revised during the hearing) out of the initial AT&T payment, plus, $18,000 per year. These amounts are about 20 percent of the initial FOG Wire system costs plus 10 percent of annual revenues, respectively, and are more than reasonable compensation. According to MPC's response to PSC Data Request Nos. 628 and 629, MPC did most of the work. (Exhs. MCC-1, pp. 12 and 13, MCC-2, pp. 12 and 13)

MCC Option 2

28. MPC should receive an annual payment of $743,000 for 25 years. This option is based on a reasonable allocation of annual transmission system costs, and it is also consistent with the FCC's cable TV attachment charge referred to by Mr. Gannon. Annual transmission system capital costs of 20 percent (return, taxes and depreciation) amount to $578,000 (based on capital investment of $14,599,000). To that Mr. Buckalew added $165,000 per year or 90 percent of the annual AT&T payment to TRI. (Exh. MCC-1, pp. 13-15)

29. According to Mr. Buckalew, FCC rules at 47 CFR Section 1.1409(c) state that a pole attachment charge should reflect the costs of capital, operations, and maintenance. Since the FOG Wire occupies 20 percent of MPC's transmission facilities, MPC's electric ratepayers should benefit by at least that percentage of the ongoing maintenance, operation and capital costs of MPC's facilities, not just operating and maintenance costs. (Exh. MCC-1, p. 14)

30. Mr. Buckalew noted that the attachments at issue in the FOG Wire project involve much larger transmission structures and communications transmission capacity exceeding normal cable TV capacity by about 50 times. As a result he computed a reasonable annual charge on that basis to be approximately $1,125,000 ($3.00 per pole attachment times 50 channels times 7,500 poles). However, Mr. Buckalew is only recommending an annual charge of $743,000. (Exh. MCC-1, p. 15)

MPC Rebuttal Testimony

31. On June 19, 1992, MPC filed rebuttal testimony on the FOG Wire issue from Mr. Gannon and Mr. Eugene Braun, and proprietary testimony from Mr. Meldahl. Mr. Gannon indicated that the Utility Division decided that the risks were too great to assume ownership of the FOG Wire. In Mr. Gannon's opinion it was clearly better for utility customers if they could benefit while being exposed to little or no risk. He stated that from a before-the-fact analysis of the risks the Electric Utility decided the risks of the project were not appropriate for its electric customers to assume. (Exh. MPC-1, pp. 2 and 3)

32. According to Mr. Gannon, one of the largest unknown costs in the FOG Wire project was the cost of obtaining appropriate rights-of-way. Many of MPC's electric transmission easements did not include telecommunications use which made it necessary to negotiate with many individuals. MPC was particularly concerned with negotiating with the Salish-Kootenai Tribe. Mr. Gannon stated, "From a hindsight perspective, it appears that obtaining the necessary easements in time was not difficult." (Exh. MPC-2, pp. 5-6)

33. Mr. Gannon noted that if MPC had taken ownership of the FOG Wire, it would have been responsible for the project for the

next 25 years. MPC believed that the Commission would not require ratepayers to assume that responsibility when the FOG Wire is not a necessary element of the utility business of providing reliable electric service to its customers. (Exh. MPC-2, p. 7)

34. Other concerns offered by Mr. Gannon included MPC's concern that an environmental impact statement (EIS) would be required before the FOG Wire project would be allowed to proceed and concern that ownership of the FOG Wire would cause the Utility to be regulated by the Federal Communications Commission (FCC). (Exh. MPC-2, p. 7) An EIS was not ultimately required.

35. Mr. Gannon disputed Mr. Buckalew's statement that MPC used TRI to realize a large windfall profit from the FOG Wire project. He indicated that once MPC made the decision not to assume ownership of the FOG Wire and to allow use of its transmission system for this project, the Company knew it would come under scrutiny for its involvement in an affiliated transaction. Therefore, the Utility made absolutely sure it received reasonable compensation for the use of its facilities. (Exh. MPC-2, p. 8)

36. Mr. Gannon's opinion is that a revenue requirement adjustment is not justified using either of MCC's proposed options. Option 1 should not be used as TRI's profitability is not the issue before the Commission and should not become the issue. The issue is whether the Utility has received adequate compensation for the use of its property. (Exh. MPC-2, pp. 9 and 10)

37. Mr. Gannon agreed that MCC Option 2 addressed the correct question, i.e., reasonable compensation. He stated that Mr. Buckalew's analysis began with a transmission cost based on 1990 costs which is far higher than the original cost of the transmission system. Mr. Gannon stated that MPC witness Mr. Braun recalculated the transmission costs using a more accurate estimate of original system cost. This calculation is presented in Mr. Braun's testimony. (Exh. MPC-2, p. 10)

38. Mr. Gannon noted that in both MCC options there is a proposal to adjust MPC's revenue requirement by $165,000 for 25 years. This amount is 90 percent of the annual payment for

maintaining the FOG Wire. If ratepayers were to receive the benefit of this payment, they would also be responsible for the maintenance of the FOG Wire. The risk of maintenance (including replacement) of the FOG Wire for the next twenty-five years is exactly the risk MPC avoided for its customers. (Exh. MPC-2, pp. 10 and 11)

39. Mr. Gannon reiterated that when considering the pole attachment fee, the annual payment of O&M for the MPC structures, the 48 microwave channels, the free inspection, and the upgrades to the system, there could be no question that the Utility received adequate compensation. (Exh. MPC-2, p. 12)

40. Mr. Braun's testimony provided rebuttal of the following MCC allegations: MPC ratepayers have taken on risk associated with the FOG Wire project; the Utility has not received reasonable compensation; and TRI's FOG Wire project does not compare favorably with PP&L's FOG Wire project. (Exh. MPC-4, pp. 2 and 3)

41. Mr. Braun disputed that the FOG Wire project has created additional risk for MPC and its customers. According to Mr. Braun, the concerns raised by Mr. Buckalew regarding the O&M payment and the fact that the FOG Wire is an integral part of utility service are not risks, but are benefits. Further, Mr. Buckalew's concern over transferring the advantage of being a competitive communication supplier to the stockholder is really a question of whether reasonable compensation was received. If the Commission determines that adequate compensation was received, then there are no risks to the Utility. (Exh. MPC-4, pp. 3-6)

42. The annual O&M payment that MPC will receive from TRI is for maintenance of the MPC structures. Mr. Braun noted that absent this payment, the ratepayers would be paying the total O&M cost. Thus, the annual payment of O&M is not a risk, but is actually a continuing benefit. Mr. Braun pointed out that the capping of the O&M payment, which will grow with appropriate interest, was discussed within the Utility. The Utility concluded, based on O&M history from 1985 through 1988, that the compensation to be paid by TRI for O&M was reasonable. (Exh. MPC-4, p. 3)

43. Mr. Braun further disputed that the FOG Wire itself was

a risk to providing utility service. He stated:

> The FOG Wire acting as a shield wire is better than the static wire it replaced. It is stronger and has less impedance. Any unforeseen problems that occur with the FOG Wire will be paid by TRI because TRI owns the FOG Wire and is responsible for it. (Exh. MCC-4, p. 5)

Therefore, this is another benefit for the Utility, not a risk.

44. In responding to claims that MPC has transferred any advantage it has as a competitive communications supplier to stockholders instead of ratepayers, Mr. Braun indicated if MPC were a competitive communications supplier, that advantage would go to the ratepayer. However, MPC is not a competitive communications supplier and does not want to take on the risk and potential federal regulation by the communications industry. Mr. Braun explained that through the FOG Wire transaction MPC did help to lower electric costs for ratepayers by ensuring that reasonable and adequate compensation was received by MPC for the use of its system. (Exh. MPC-4, p. 5)

45. Mr. Braun responded to Mr. Buckalew's criticism of the value of compensation MPC received. First, Mr. Braun disagreed with Mr. Buckalew's value of the 48 digital microwave channels. MPC regards this part of the transaction as conveying the most value to the Utility. The 48 channels are not channels on the FOG Wire, and therefore, MPC is not limited to use between the FOG Wire endpoints. In Mr. Braun's opinion, having the 48 microwave channels available wherever TRI provides service in Montana is a greater benefit than retaining channels on the FOG Wire. (Exh. MPC-4, pp. 6 and 7)

46. Mr. Braun admitted that to date (June, 1992) MPC has used only two channels, but stated that MPC anticipated using the remaining channels by early 1994. He explained that significant additions to the supervisory control system have resulted from the Gas Utility beginning to transport gas. Existing TRI microwave channels do not access the areas required by the Gas Utility. Therefore, the MPC analog communication system

continues to serve these areas and will continue to do so as the needs of the Gas Utility expands. The Gas Utility needs are presently absorbing analog capacity as it is made available by transferring other service needs to the 48 microwave channels. (Exh. MPC-4, pp. 6-8)

47. Mr. Braun stated that the 48 microwave channels are primarily used for data transmission for the communication system. The communication system is essential for the reliable and safe operation of the Company's electric and gas systems. No technology can perform these essential communication functions as rapidly, reliably and economically as microwave. (Exh. MPC-4, p. 8)

48. MPC does not believe that the value to MPC of the 48 microwave channels should be based on the market value of the channels, but instead on the value the ratepayers will realize from deferring the costs of building a new microwave system. Mr. Braun did, however, dispute the statement by Mr. Buckalew that 48 microwave channels do not cost $300,000 if leased from a communications supplier. Mr. Braun indicated, based on previous quotes MPC received for 56 kps circuits, that MPC calculated the annual market value for the 48 circuits to be $374,400. The present value for 25 years at this rate is $3.1 million, or $4.6 million if a 5 percent CPI factor is used. (Exh. MPC-4, pp. 8 and 9)

49. Mr. Braun reiterated that the value MPC has placed on the 48 channels is not the $4.6 million market value of the channels, but $2 million, based on the ability of the channels to defer construction of a new microwave system. Thus, it is irrelevant how many of the 48 channels are in use. (Exh. MPC-4, p. 9)

50. Second, Mr. Braun continued to support the $480,000 value MPC placed on the O&M portion of the TRI contract. He stated that it is always difficult to calculate future maintenance costs but MPC made a reasonable attempt to do so. He indicated that the current cap of $57,854 on the O&M payment will escalate annually based on the Consumer Price Index (CPI). According to Mr. Braun, MPC will certainly receive at least $480,000 over the term of the contract. (Exh. MPC-4, pp. 9-10)

(NOTE: The $480,000 represents the present value of $57,854 for 25 years without an increase for CPI.)

51. Third, Mr. Braun disputed Mr. Buckalew's statement that the inspection MPC received had no value. The value assigned by MPC to the inspection is $250,000. Mr. Braun stated that through a contract with TRI, Power Engineers performed an inspection of the structures to be used for the FOG Wire project. "MPC would have had to complete this inspection within a reasonable time had the FOG Wire project not been developed by TRI." (Exh. MPC-4, p. 11) He indicated that TRI paid for half of the costs to upgrade sections that did not meet the National Electric Safety Code (NESC). TRI also paid for upgrades that were needed specifically for the FOG Wire. The total system improvements equaled $448,441 ($321,136 was paid by TRI; $127,305 was paid by MPC). (Exh. MPC-4, pp. 10-12)

52. Mr. Braun also disputed Mr. Buckalew's findings that more compensation is required to cover the cost of using the transmission system. MPC believes the $3.33 million in compensation it received is more than reasonable compensation for use of the facilities. MPC agreed with the type of calculation that Mr. Buckalew performed in deriving Option 2, but disagreed with the original cost amount that was used in the FCC formula. Mr. Braun indicated Mr. Buckalew calculated the original cost for the support structures by using the 1990 average capital cost. However, the various transmission lines on which the FOG Wire was attached were not built in 1990. Mr. Braun developed a ratio method for calculating the original cost of the structures. Mr. Braun used an original cost amount of $5,830,961, applied the same remaining factors as Mr. Buckalew, and arrived at an annual support structure charge of $170,122 (present value of 25 years, discounted at 11.25 percent is $1.413 million, or $2.08 million if a 5 percent CPI factor is included). Since this value is considerably less than the $3.33 million MPC believed it received, no adjustment is necessary. (Exh. MPC-4, pp. 12-15)

53. Finally, Mr. Braun stated that there are many differences between the PP&L FOG Wire project and the TRI FOG Wire project, and thus they can not be compared.

MPC did not need fiber from Billings to

> Thompson Falls. We have no reason to occupy fiber for that segment. MPC did not and still does not require a large data transmission system interconnected to another utility or interconnected for relaying purposes. It appears to me that PP&L needed such a facility. MPC needs what TRI is providing - channels to various sites within the MPC service territory, where we can utilize the channels from these areas to our Utility headquarters in Butte ... Therefore, we found ourselves in a totally different situation than exists with the PP&L fiber project. It appears PP&L took all of the risk of acquiring rights-of-way, determining adequacy of easements and obtaining new permits where necessary. MPC did not want to take the risk ... (Exh. MPC-4, pp. 15-16)

54. Mr. Meldahl's proprietary rebuttal testimony addressed five topics:

(1) The characterization of the FOG Wire transaction as an opportunity to record large windfall profits for MPC shareholders is unfair and wrong.
(2) The profit sharing provisions and obligations of the partnership agreement between TRI, Alcoa and John Warta.
(3) The profit TRI received for the FOG Wire project is not a windfall and is exaggerated by MCC.
(4) The annual maintenance payment paid by AT&T to TRI is to maintain, repair and replace the FOG Wire system in routine and emergency situations and is not profit.
(5) A calculation which is based on communications transmission capacity of the fiber optic cable to determine a reasonable annual charge for the use of MPC's transmission system is not a fair indication of reasonable compensation.

(Exh. MPC-6)

55. The hearing for the reserved issues was held July 14 and 15, 1992. During the hearing MCC questioned the logic of using a ratio formula, as Mr. Braun had done, in developing the net investment number to be used in the FCC formula. MCC argued that the H-frame structures, the type the FOG Wire is attached to, represented 65 percent of the costs and only 37 percent of the transmission miles. MCC used the MPC 1991 Federal Energy Regulatory Commission (FERC) Form-1 as support for this statement. As a result of this line of questioning, MPC agreed to provide a late filed Exhibit, using the FERC Form-1, to recalculate the original cost that was used in the FCC formula. Mr. Braun agreed that using portions of the FERC Form-1 would be more representative of the actual costs of the transmission system that the FOG Wire is attached to than the costs he originally provided.

56. On July 27, 1992, MPC filed Late Filed Exhibits 1-5 for the reserved issues in this Docket. In Late Filed Exhibit No. 1, MPC provided a recalculation of the original cost less depreciation for the structures used in the FOG Wire project.

Mr. Braun calculated the net investment to be $3,557,640. The resulting annual support structure attachment charge was reduced to $144,790.

COMMISSION DISCUSSION

57. The question before the Commission is whether MPC received adequate compensation for its participation in the FOG Wire project.

DETERMINING ADEQUATE COMPENSATION

58. The Commission first determines the means by which to gauge adequate compensation. MCC witness Mr. Buckalew indicated the second option he presented was consistent with the cable TV attachment charge. Mr. Buckalew stated:

> The FCC rules (47 CFR Section 1.1409(c)) state that a pole attachment charge should reflect the costs of capital, operations and maintenance. Specifically, a telephone company can charge a cable TV operator no less than the added cost of using the pole and no more than the attachment's share of the O&M costs plus the capital costs of the facility. (Exh. MCC-1, p.14)

59. MPC does not dispute using the FCC formula, but does disagree with MCC as to the value of the original cost to be used in the FCC formula. The calculation provided by Mr. Braun in MPC Late Filed Exhibit No. 1 used actual costs, less conductors and devices, as a measure of the original cost. Mr. Buckalew advocated using an original cost based on the cost per structure in 1990.

60. The method proposed by Mr. Buckalew in Option 1, looking at TRI profits, results in the amount of MPC compensation being dependant on the profitability of the FOG Wire project. In hindsight, there is no question that the FOG Wire project was profitable. However, the Utility's intent was to reduce the risk to the ratepayers to zero. The method used by Mr. Buckalew in Option 2 based the compensation to MPC on the asset that MPC provided in the FOG Wire project, the transmission system. This method is not dependant on the profitability of the FOG Wire project. The level of compensation is guaranteed. The Commission finds that the FCC formula is preferable in evaluating the level of adequate compensation required from the FOG Wire

project.

61. The original 1990 costs proposed by Mr. Buckalew in the FCC formula overstates the value of the transmission system. Therefore, the Commission finds that actual costs should be used in the original cost calculation. The Commission disagrees with MPC that the costs for conductors and devices should be deducted. Functionally, MPC uses the FOG Wire as a static wire. The FOG Wire, acting as a static wire, is an integral part of the transmission system. The conductors and devices are also an integral part of the transmission system. The Commission finds that conductors and devices should be accounted for in the FCC formula.

62. MPC Late Filed Exhibit No. 1, as submitted by Mr. Braun, was adjusted to include the conductors and devices which he deleted. The net investment number to be used in the FCC formula is $7,316,686. The resulting annual support structure attachment charge is $282,176. The present value of this payment for 25 years using an 11.25 percent discount rate is $2.33 million.

63. The Commission finds that adequate compensation in the FOG Wire project is $2.33 million.

REVIEW OF COMPENSATION

Pole attachment fee

64. MPC has stated they received $600,000 as part of the pole attachment fee. When MCC witness Mr. Clark was discussing the discrepancy in the amount of the system upgrades he stated: "Regardless of the actual amount, however, the payment received from TRI should be regarded as $600,000." (MCC Supplemental March 19, 1991, AEC, p. 20). In Order 5484k, FOF 254, the Commission determined that $600,000, amortized over a 5-year period, should be reflected for ratemaking, resulting in increased revenues of $120,000 and an average rate base offset for the amortization period of $183,967. In Order 5484p, FOF 69, the Commission granted interim treatment to these revenues.

65. The Commission finds that $600,000 in compensation was received by MPC as a result of the FOG Wire project. The Commission confirms the previous decision that a 5-year amortization is appropriate. The 5-year amortization period

results in increased revenues of $120,000 with an average rate base offset for the amortization period of $183,967.

Operation and Maintenance

66. As a result of the FOG Wire project, TRI will reimburse MPC for the lesser of $57,854, adjusted for inflation, or 20 percent of the transmission system O&M expenses incurred by MPC.

67. MCC expressed concern with the cap, indicating there was no guarantee that the ceiling would always be enough to cover the TRI share of transmission O&M.

68. According to Mr. Braun "MPC would have to pay that amount [the lesser of the cap and 20 percent] if it did not have the fiber line on its transmission system. Having the fiber inside the ground wire simply reduced MPC's transmission line maintenance by 20 percent." (PSC Data Request 621)

69. The Commission cannot predict what will happen with future O&M expenses. The Commission recognizes that absent the FOG Wire project ratepayers would be responsible for all prudently incurred O&M expenses. MPC will receive the lesser of the cap, increased for inflation, and 20 percent of incurred maintenance expenses. The cap was determined based on historical levels of O&M. The Commission finds that MPC received compensation in the amount of $480,000 as a result of the FOG Wire project.

48 Digital Microwave Channels

70. MPC relies on an analog microwave system with a capability of generally 300 channels for most aspects of its communication needs. The analog system is utilized for voice transmission, data transmission, supervisory control of substation facilities, automated operation of a substantial portion of the hydro facilities and the operation of the production, transportation and distribution functions of the gas utility. The analog system is currently loaded with approximately 325 channels. MPC stated:

> There is considerable cross-talk between channels and other interference problems that have begun to affect the quality of the communications and data being transmitted and received. (Exh. MPC-3, p. 5)

71. MPC was able to convert channels from its overloaded

analog system to the digital microwave channels that were provided by TRI. MPC has indicated that by obtaining the 48 channels it was able to defer construction of a microwave system to replace the analog system.

72. MCC believes the 48 channels have little or no value because only a few of them are currently being used. During the hearing, Commissioner Macy discussed the likelihood, when a microwave system is being constructed, of being able to incur only the costs of a few channels now, and incurring the costs for the remaining channels at a later date. Mr. Buckalew suggested a new system would be probably include more than 48 channels, and indicated "... there's a possibility of buying smaller lumps, but by and large, you're probably going to have to buy a good chunk of it, spend a good chunk of that money." (Tr. p. 195)

73. The value MPC has attributed to deferring construction is $2 million. This amount is based on the present value of carrying charges of 20 percent for a $4 million project. The Commission finds that 50 percent of the $2 million should be recognized in the evaluation of adequate compensation. The Commission finds that compensation in the amount of $1 million is allowed as a result of deferring construction.

Inspection

74. An inspection of the transmission system which is occupied by the FOG Wire was performed by Power Engineers. MCC maintained that the inspection had no value to MPC because (1) MPC does its own inspection of facilities and (2) MPC stated that the inspection was not absolutely necessary.

75. During the hearing Commissioner Anderson asked Mr. Braun the following questions:

> Q. In the absence of the project, would there have been an inspection done?
>
> A. The answer to that question is yes. We have a policy within our company to inspect all of our transmission lines once every five years. So this in some instances now accelerated portions of that.
>
> Q Would the cost to MPC of that inspection in the absence of the project have been $250,000

A. I believe it would have been higher than $250,000.

(Tr. 112 and 113)

76. Who will perform the inspection is a management decision that is left to the Utility. MPC engineering staff worked with Power Engineers to establish necessary criteria. The Commission finds that it is not who performed the inspection that determines whether or not the inspection has value.

77. Regulating entities have not prescribed specific inspection timetables for MPC to follow. Deciding when, where, and what type of inspection is to be performed is also a management decision that is left to the Utility. MPC stated:

> In light of the fact that all of the transmission lines to which the fogwire have been attached were at least 20 plus years old and some facilities were built in the decade of the 1910's, this type of inspection is warranted especially when it can be obtained with minimum cost. (Exh. MPC-3, p. 7)

78. Mr. Braun indicated the cost to MPC to perform this inspection would have been greater than $250,000. The Commission finds that MPC received compensation in the amount of $250,000 as a benefit from the inspection.

COMMISSION DECISION

79. The Commission finds that the total compensation received as a result of the FOG Wire project was $2.33 million. The $2.33 million equals the level of adequate compensation required under the FCC formula. (See FOF 62 herein.) Therefore, the Commission finds that MPC received adequate compensation for its involvement with the FOG Wire project.

80. Mr. Buckalew proposed that MPC receive 90 percent of the $183,000 annual payment that TRI receives from AT&T for maintaining the FOG Wire. Mr. Buckalew indicated that MPC would receive this payment, $165,000 annually, instead of 20 percent of the O&M (up to $57,854 adjusted for inflation) that MPC incurs for maintenance of the transmission structures. (Tr. 186-188) The Commission rejects Mr. Buckalew's proposal. The Commission

has determined that MPC received adequate compensation for the FOG Wire project. Further, Mr. Buckalew agreed that by imputing the $165,000 to the electric utility, MPC would assume responsibility for maintaining the FOG Wire and would also be required to cover any loss from maintenance of the FOG Wire. (Tr. 186-188) Currently, MPC will receive the 20 percent payment for operation and maintenance of the structures, and will have no responsibility for maintaining the FOG Wire. Therefore, rejection of Mr. Buckalew's proposal is consistent with the decision to eliminate risk to the Utility and to the ratepayers.

81. MPC has continually professed that it assumed no risk in the FOG Wire project. MPC stated:

> The electric utility customers receive reasonable and adequate compensation for the use of the transmission facilities and have none of the risk involved. (Exh. MPC-2, p. 13)
>
> MPC can foresee nothing that will cause increased expenses to MPC ratepayers because of the project ... (Exh. MPC-2, p. 13)

The Commission's finding of adequate compensation is based on the value of the MPC transmission system that was used by TRI. This calculation does not include compensation for acceptance of current or future risks. Incurring future expenses as a result of the FOG Wire project would represent risk. Therefore, the Commission finds that any future expenses incurred by MPC as a result of the FOG Wire project will not be recognized for ratemaking.

82. The Commission cannot conclude this issue without some observations. MPC's conduct in this affiliate transaction is questionable. Mr. Gannon stated:

> Once MPC made the decision not to assume ownership of the Fogwire and to allow use of its transmission system for this project, MPC knew it would come under scrutiny for its involvement in an affiliated transaction. (Exh. MPC-2, p. 8)

83. During the hearing Ms. Peterson questioned Mr. Meldahl as to why, when MPC and TRI were asked to provide time sheets of

employees who worked on the installation of the FOG Wire, TRI only submitted time sheets for one employee. Mr. Meldahl indicated that only one TRI employee working on the project actually filled out time sheets. Others worked on the project, but did not keep track of their time. The Commission finds that there is no substitute for keeping adequate time records. MPC and TRI did foresee that the affiliate transaction would come under scrutiny and should have kept better records.

84. PSC Data Request No. 632 was sponsored by Mr. Gannon. This Data Request asked for documents prepared in completing the before-the-fact analysis discussed by Mr. Gannon. Ms. Peterson questioned Mr. Gannon as to why this document indicated that MPC placed a market value on the 48 microwave channels of $120,000 per year versus the $374,400 that MPC later testified too. Mr. Gannon was unable to answer the question and said Ms. Peterson should ask Mr. Braun. When Ms. Peterson asked Mr. Braun the same question, he too was unable to answer the question. Later on redirect, Mr. Braun said that Ms. Peterson should ask Mr. Meldahl. At this point the Commission wonders who performed the analysis, MPC or TRI. It seems unlikely that if this were not an affiliate transaction, MPC would ask the parties "sitting across the table" to testify as to how MPC's own numbers were calculated.

85. Finally, the potential cost of obtaining rights-of-way for the FOG Wire was a major concern of the Utility and was central to the FOG Wire issue. In MCC Data Request No. 359 MCC asked MPC to "provide a list and the cost of each right-of-way secured by TRI or AT&T to complete the FOG Wire construction." During the hearing, Ms. Peterson attempted to confirm that the amount listed in the response was the total amount paid for rights-of-way. Mr. Meldahl indicated that the response was "... only a partial of that total cost." (Tr. p. 137) There were additional rights-of-way costs with landowners and federal and state lands.

86. Further, Mr. Meldahl agreed that where MPC was the landowner, they were compensated like any other landowner. However, Ms. Peterson questioned Mr. Meldahl why, in MCC Data Request No. 359, when MPC was the landowner, there were no

payments listed. Mr. Meldahl indicated that was because TRI negotiated with MPC directly. Again, the data request asked for the cost of each right-of-way secured. MPC agreed to provide a late filed exhibit displaying the amount TRI paid MPC for rights-of-way when MPC was the landowner.

87. MPC Late Filed Exhibit No. 2 listed only the Kerr Dam area and Thompson Falls. The question Ms. Peterson asked had pointed out specific MPC locations. These locations were not accounted for in the late filed exhibit.

88. With MPC's acknowledgement of Commission scrutiny for affiliated transactions and the importance of rights-of-way to the FOG Wire issue, the Commission is displeased at the callousness and disregard exhibited by MPC in failing to respond to multiple requests for information regarding the rights-of-way. The Commission determines that this behavior is improper for a regulated entity.

89. MPC should not interpret the finding that adequate compensation was received as Commission approval of the Utility's decision not to participate more fully in the FOG Wire project. It is clear that the Corporation viewed this project in a favorable light. A memorandum from D.M. Leuschen and D.T. Berube stated that "the Montana Power Corporation has a good opportunity to benefit from such a project in many ways." (PSC Data Request no. 632)

90. MPC stated it performed a before-the-fact analysis of the risk. However, MPC provided insufficient documentation of the financial, legal or other risks that MPC considered in ultimately rejecting the project. Furthermore, MPC did not perform an economic analysis of these risks. The Commission expects MPC to evaluate future affiliate transactions in a more thorough manner.

FINDINGS OF FACT: RECIPROCAL SHARING ARRANGEMENT (RSA)

Background

91. The RSA is a power exchange in which MPC's Utility Division exchanges one-half of its Colstrip 3 output for one-half of the Colstrip 4 Lease Management Division's (CS4LMD) Colstrip 4 output. The RSA was implemented on January 1, 1989.

92. On January 28, 1991, the Commission issued Order No.

5484h which identified several new issues including the RSA issue. The Commission expressed interest in the ratemaking ramifications of the contractual dedication of Colstrip Unit 3 output in the power sales contracts to the Los Angeles Department of Water and Power (LA) for the period July 17, 1989 through December 29, 2010 and Puget Sound Power and Light Company (Puget) for the period October 1, 1989 through December 29, 2010. The issues identified in Order No. 5484h included: (1) whether physical delivery of power from Colstrip 3 to retail customers would always be possible while the same power was obligated contractually to LA and Puget; and (2) whether the LA and Puget contract provisions affect the implied dedication of Colstrip 3 to MPC retail customers for its life cycle, absent extenuating or materially changed circumstances. The Commission requested that a thorough analysis of these issues be presented.

93. In February of 1991, MPC filed prefiled supplemental testimony on the RSA issue. (WAP, pp. 34-41) MPC witness Mr. William Pascoe maintained that Colstrip 3 can be dedicated to serving Montana customers and also be utilized to deliver power to LA and Puget because of the RSA between the Utility Division and CS4LMD. Mr. Pascoe stated that "under this arrangement the Utility Division receives 15 percent of the output of each of Colstrip 3 and Colstrip 4 rather than receiving 30 percent of the output of Colstrip 3 and no output from Colstrip 4." (Prefiled supplemental, February, 1991, WAP, p. 35)

94. Mr. Pascoe maintained that the RSA provided benefits to both the Utility Division and the CS4LMD. First, the RSA reduces risk by diversifying the power supply mix. For example, in February, 1989, during a severe cold front, Colstrip 3 was forced off-line and the Utility Division received 15 percent of Colstrip 4's output. Second, the RSA minimizes operational conflicts that could arise between the Utility Division, the CS4LMD and the other Colstrip 3 & 4 partners. For example, the optimal time during the year for maintenance and inspection of the units is the Water Budget ("fish flush") period. With the RSA there is no conflict over maintenance scheduling, because both entities benefit equally no matter which unit is maintained during the this period. Mr. Pascoe added that times may exist

when it is more efficient to run one unit with system output of 700 MW than 2 units, each with system output of 350 MW. Again, with the RSA, there is no conflict over which unit to take off-line because both entities would continue to receive power from whichever unit remained on line. (Prefiled supplemental, February, 1991, WAP, pp. 35-37)

95. Mr. Pascoe stated the effect that the RSA had on the revenue requirement in this Docket was a $650,000 reduction. The generation from Colstrip 3 and 4 was normalized using the reciprocal sharing concept and averaging the output for 1988 and 1989. During the two year period, the capacity factor of Colstrip 4 exceeded that of Colstrip 3. The test year generation was about 68,000 MWH higher than if the generation had been based solely on Colstrip 3 production. Multiplying 68,000 MWH by the difference between the variable cost (7 mills/kwh) of the extra generation and the average cost (16.5 mills/kwh) of spot market purchases resulted in the $650,000. (Prefiled supplemental, February, 1991, WAP, p. 40)

96. Further, Mr. Pascoe maintained that the Commission should not be concerned about the rate-based facility's involvement in the RSA. Mr. Pascoe stated that "this [the RSA] concept is identical to the concepts embodied in the Utility Division's other power exchanges." (WAP, p. 41) According to Mr. Pascoe, both the seasonal exchange contract with Idaho Power and the peak/energy exchange contract with BPA involve power generated at Utility Division rate-based facilities which is delivered in exchange for power generated at Idaho Power's facilities and BPA's facilities respectively. (Prefiled supplemental, February, 1991, WAP, p. 41)

97. Mr. Pascoe contended that the Commission's concern with the power exchanges should be whether the transactions provide net benefits for Montana ratepayers. Mr. Pascoe stated that "the RSA, the Idaho Power seasonal exchange and the BPA peak/energy exchange all meet that test." (Prefiled supplemental, February, 1991, WAP, p. 41)

98. On March 19, 1992, MCC filed prefiled supplemental testimony on the RSA issue. (AEC, pp. 7-11) MCC witness Mr. Al Clark indicated that MPC had failed to address what he believed

to be the Commission's true concern: Montana ratepayers are receiving 15 percent of output from both Colstrip 3 and 4, but are paying for 30 percent of Colstrip 3. He added, "The Commission noted at page 6 of Order No. 5484h:

> Colstrip Unit 4 costs, which are significantly lower than those of Colstrip Unit 3 because Colstrip Unit 4 is leased ..."

Mr. Clark did not dispute Mr. Pascoe's calculation of the $650,000 benefit, but indicated that the calculation ignored the fixed cost of the two units. He stated that it was unclear at this time whether Montana ratepayers would be better off paying for what they were actually receiving [15 percent of both Colstrip 3 and 4] or 30 percent of Colstrip 3. (Prefiled supplemental, March 19, 1992, AEC, pp. 7,8 and 10)

99. Further, Mr. Clark maintained that the CS4LMD benefited more than the Utility Division did from diversifying the power supply mix. He noted that without the RSA, the CS4LMD had only one generating resource while the Utility Division still had Colstrip 1 and 2, Corette, and the hydro system as well as Colstrip 3. Mr. Clark also disputed Mr. Pascoe's claim that the RSA minimized operational conflicts with other partners. Mr. Clark contended that the RSA does not minimize operational conflicts with the other Colstrip partners because the other partners own the same proportion of each unit. (Prefiled supplemental, March 19, 1992, AEC, pp. 8 and 9)

100. Mr. Clark indicated that the issue was far too complicated to resolve in this proceeding. He recommended that the Commission institute a separate docket to resolve any relevant concerns with the RSA.

101. On April 11, 1991, MPC filed prefiled supplemental rebuttal testimony. (WAP, pp. 1-3) Mr. Pascoe disputed Mr. Clark's statement that the RSA holds more potential for the CS4LMD. Mr. Pascoe explained that the service obligation of the Utility Division is to provide continuous, reliable service. However, CS4LMD, is generally not obligated to deliver power to LA and Puget when its facilities are not operating. Mr. Pascoe compared the ratios of capacity available from MPC's share of

Colstrip 3 and 4 to the 1990 peak loads for the Utility Division, LA, and Puget. Mr. Pascoe concluded that since the Utility Division's ratio was greater than that of LA or Puget, the additional diversity from the RSA had greater value to the Utility Division.

102. Mr. Pascoe admitted that LA and Puget have similar utility service obligations as MPC and would place some value on the RSA. Mr. Pascoe stated "this additional value was presumably considered by LA and Puget in contract negotiations with CS4LMD." (Prefiled supplemental rebuttal, April 11, 1991, WAP, p. 2)

103. On July 17, 1991, the Commission issued Order No. 5484k. In that order the Commission found that in addition to obvious operational impacts, there were at least three ratemaking aspects to the RSA. First, normalizing test year generation using conventions set forth in the RSA could increase revenues required in a future MPC electric case. Second, MPC has not, and may not be able to, quantify (in dollar terms) the reduction in risk to the electric utility. Third, MPC has not addressed the issue of fixed costs of the Colstrip 3 and 4 units. (FOF 203, Order No. 5484k)

104. The Commission noted that before this Docket, MPC had never identified Colstrip 3 as requiring mitigation of risk through a power exchange. Further, the Commission stated that when a power exchange involves a nonutility affiliate, MPC assumes a greater burden of persuading the Commission that increased risk exists and that the exchange is needed. (FOF 204, Order No. 5484k)

105. Mr. Pascoe stated that the RSA is a "two way street on which benefits will be transferred in both directions over the course of time." (Prefiled supplemental, February, 1991, WAP, p. 39) Reduced risk implies reduced costs or rate impacts. Mr. Pascoe was unsure of whether or not MPC could quantify other risk reductions in dollar terms. The need to reduce the risk of Colstrip 3 seemed simply to be a matter of MPC's judgement, which was not expressed by MPC when the Commission originally considered rate treatment for Colstrip 3. (FOF 205, Order No. 5484k)

106. The Commission found that MPC had not met its burden of

proof with respect to the RSA. MPC had not demonstrated the effects of the RSA on MPC's Montana utility operations or the life cycle rate-making impacts. Therefore, the Commission directed MPC to file exhibits to quantify the impacts, including all potential costs and benefits accruing to the electric utility and the CS4LMD, to the termination of the RSA. The Commission also directed MPC to calculate the fully allocated life cycle costs of Colstrip 3 and 4 and to provide testimony on whether MPC explored a similar RSA with other nonaffiliated entities. The Commission required MPC to demonstrate that the claimed reduction in risk to the electric utility would not affect its cost of capital. On an interim basis the Commission included $650,000 in rates. (FOF 206, Order No. 5484k)

107. On July 30, 1991, MPC filed a Motion for Reconsideration, claiming that Order No. 5484k contained errors in logic and fact and that there was no evidence that the Utility executed the RSA in order to reduce an unacceptable level of risk in the operation of Colstrip 3. MPC maintained that the requirement to file certain information violated the law concerning burden of proof and that Order No. 5484k was too vague in its filing requirements.

108. MPC claimed that it would be impossible to quantify all potential costs and benefits because MPC would have to be able to predict exactly what would occur over the lives of Colstrip 3 and 4. MPC could perform a life cycle analysis of the two units but it would have to make many assumptions. MPC proposed, as an alternative to the Commission directed procedure, that it prepare the requested life cycle cost analysis along with a narrative description of the analysis. MPC would be available to answer questions, and if any party (or the Commission staff) thought Commission action was required, then that party would go forward using the statutory complaint procedure.

109. On August 12, 1991, MCC filed a response to MPC's Motion for Reconsideration. MCC stated that MPC was the proponent of the adjustment, and that MPC's burden of proof was heightened in the context of affiliate transactions. MCC believed that the Commission had explicitly spelled out in FOF 206 what it wanted from MPC. MCC stated that MPC has the burden

of proof with respect to changing its rate levels and has the obligation to produce information which bears on its request.

110. On November 7, 1992 the Commission issued Order on Motions for Reconsideration, Order No. 5484p. The Commission found that MPC's objections to the RSA procedure were substantially without merit. The Commission also found that MPC's objections indicated a need to clarify FOF 206 and to explain the nature of the RSA proceeding. (FOF 50, Order No. 5484p)

111. The Commission withdrew its finding that MPC had not met its burden of proof with respect to the RSA. The Commission asserted, however, that MPC was responsible in all rate cases of persuading the Commission that the approval of its various actions was consistent with the establishment of just and reasonable rates. The Commission required MPC to explain to the Commission's satisfaction the impact of the RSA on ratepayers, both present and future. (FOF 51, Order No. 5484p)

112. The Commission withdrew the requirement to file and instead invited MPC to respond by January 30, 1992, in whatever manner it deemed appropriate, to the questions raised and concerns expressed regarding the RSA issue. The Commission clarified its request for information as follows:

> The Commission does not know what the impacts of the RSA are on the operations of electric utility property that is dedicated to serve Montana ratepayers. Further, the Commission does not know the life cycle ratemaking impacts of the RSA. In order to answer these questions, the Commission must, at a minimum, be able to quantify all potential costs and benefits of the RSA (to the extent these can reasonably be identified) which will accrue from the date of this Order until the projected termination of the RSA, to the Montana electric utility and the CS4LMD. Accordingly, MPC must calculate the fully allocated life cycle costs of Colstrip 3 and Colstrip 4 (individually) for the above-described period. MPC should provide a narrative description of the life-cycle cost analysis. MPC should also address whether it explored an RSA for 50 percent of Colstrip 3 output with other, nonaffiliated entities.

> Similarly, MPC should explain why there is an RSA with Colstrip 4 in particular. In addition, MPC should analyze and explain whether the reduction in risk which it claims will accrue to the electric utility has any impact on its cost of capital. (FOF 54, Order No. 5484p)

MPC Request for Final Order

113. On January 31, 1992, MPC filed a request for final order regarding the RSA issue. MPC witnesses included Mr. Pascoe, Mr. Charles Olson and Mr. Perry Cole. MPC maintained that the RSA allows the Utility to comply with the Project Agreements it entered into in 1981 which require the Utility, as the managing partner, to operate the Project in a way which efficiently meets the combined needs of all of the owners. Mr. Pascoe stated that the Project Agreements do not allow any of the owners to request specific amounts of generation from either unit. Rather, the Project Agreements require each owner to request an amount of generation from the Project (both units). Because subsequent regulatory treatment and management decisions have resulted in the Utility owning MPC's share of Colstrip 3 and CS4LMD leasing MPC's share of Colstrip 4, the need arose for an arrangement to avoid conflict and preserve efficiency. This need can only be satisfied with an arrangement between the Utility and CS4LMD and, therefore, the Utility did not explore an RSA with other entities. (Exh. MPC-7, pp. 1-4)

114. Mr. Pascoe maintained that it is possible, in at least one regard, to quantify the reduction in risk resulting from increased diversity. MPC is involved in sharing forced outage reserve obligations with seventeen other Pacific Northwest utilities through the InterCompany Pool (ICP) Agreement and through the ICP's interaction with the Pacific Northwest Coordination Agreement (PNCA). Mr. Pascoe stated that for the 1991-92 operating year MPC's forced outage reserve (FOR) obligation, as determined by the ICP, was 3 MW lower than it would otherwise have been without the RSA. He concluded that although the magnitude of this reserve reduction may vary somewhat from year to year, a 3 MW reduction in MPC's capacity requirements has an annual real-levelized value of $194,400

(in 1991$) based on the avoided cost rates included in MPC's February 15, 1991 compliance filing in Docket 90.8.51. (Exh. MPC-7, pp. 7 and 8)

115. Mr. Olson testified that the RSA has a positive, although not quantifiable, impact on the cost of capital. Mr. Olson stated that "... the risk reducing effect of the Utility's RSA is already reflected in the return on equity that the Commission authorized in this case." (Exh. MPC-7, p. 12)

116. Mr. Cole presented a description and an exhibit of the fully allocated life cycle cost analysis. He maintained that since Colstrip 3 and 4 are twin plants, the capital expenditures and the operation and maintenance expenses, including fuel and property tax, are expected to be equal between the units over the life of the plants. His analysis focused on the remaining life cycle costs which are different between the units, the return of and return on capital for Colstrip 3 versus the return of and return on capital for Colstrip 4 plus the Colstrip 4 lease payments. According to Mr. Cole the present value levelized revenue requirement in year 2010 for Colstrip 3 was less than that of Colstrip 4. (Exh. MPC-7, pp. 12-14) [NOTE: MPC provided a revised set of calculations in response to MCC Data Request No. 458. This set of calculations did impact specific items, but did not change the overall conclusion. Levelized revenue requirements in year 2010 were $29,926,000 and $36,887,000 for Colstrip 3 and 4 respectively.]

117. Mr. Cole stated MPC was not surprised at the results of the evaluation since a principal reason for the sale leaseback financing of Colstrip 4 was to reduce the up-front revenue requirements. However, the sale leaseback will raise the costs in future years relative to conventional financing. (Exh. MPC-7, p. 15)

118. MPC maintained that (1) the RSA allowed for the orderly and optimal operation of Colstrip 3 and 4 without additional cost to the Utility customers; (2) the RSA provided the opportunity to diversify its generation resources and thus reduce its capacity requirements; and (3) the RSA does not affect Utility customers unfairly in any manner. MPC requested that the Commission find that the ratemaking treatment presently accorded the RSA is just

and reasonable and enter a final order on the matter. (Exh. MPC-7, p. 15)

MCC Testimony

119. On May 18, 1992, MCC filed additional supplemental testimony. Mr. Clark maintained that it is not sufficient to simply make the ratepayers neutral or to provide them some level of benefit that is less than the maximum obtainable. (Exh. MCC-3, p. 8)

120. Mr. Clark maintained that the Project Agreements (1981) did not give rise to the need for the RSA since the RSA was not put into place until 1989. Further, Mr. Clark disputed that the RSA reduced operational conflicts between the other owners of Colstrip 3 and Colstrip 4. "The only real potential conflicts that could arise would be between MPC the Utility and the CS4LMD because, for purposes of regulation, these entities do not have equal interests in the two units absent the RSA." (Exh. MCC-3, p. 13)

121. Mr. Clark observed that the RSA did afford MPC the opportunity to negotiate a higher price with LA and Puget due to increased reliability. He maintained that the benefit that has been captured by the CS4LMD and MPC's stockholders is the presumed higher price for the LA and Puget sales. (Exh. MCC-3. pp. 7 and 14)

122. Mr. Clark did not agree with all aspects of the life cycle analysis performed by Mr. Cole, but he did acknowledge that even with his adjustments reflected, the ultimate conclusion remained the same. The remaining costs of Colstrip 4 exceed those of Colstrip 3. Mr. Clark recommended that "Montana rates continue to exclude all costs associated with the utility's share of Colstrip 4." (Exh. MCC-3, p. 12) (Exh. MCC-3, p. 14-21)

123. Mr. Clark maintained that the RSA will have a year-to-year impact, either positive or negative, on the electric utility's revenue requirement due to the way in which generation was normalized in this Docket. "Only the timing of any year to year differences and how they are factored into a test year revenue requirement could have any lasting impact on ratepayers." (Exh. MCC-3, p. 23) Mr. Clark suggested that the Commission could eliminate this impact by not allowing the generation

normalization process, in any test year, to include one-half of the Colstrip 4 output. (Exh. MCC-3, pp. 7 and 21-23)

124. Finally, Mr. Clark acknowledged that the RSA has the potential to provide some benefit to Montana ratepayers primarily through the reduced FOR requirement. However, Mr. Clark maintained that for the 1989-1990 and 1990-1991 operating years the ICP set MPC's reserve requirements 15 MW above the level they would have been without the RSA instead of 4 MW below that level for a total swing of 19 MW against MPC. (Exh. MCC-3, pp. 8 and 25)

125. Mr. Clark contended that this excessive reserve requirement, among other things, helped justify the Idaho power purchase during the initial phase of this Docket. Since the revenue requirement in this Docket included costs associated with the excess level of reserves, Mr. Clark recommended an adjustment. Mr. Clark measured the value of the 19 MWs of excess capacity reserves by removing a portion of the Idaho purchase from MPC's resources in this Docket, and offsetting this cost reduction by either an increase in non-firm purchases or a decrease in non-firm sales if there were not sufficient purchases in any given month. The effect of this adjustment is a net reduction of the test year expenses of $1,349,866. (Exh. MCC-3, pp. 12 and 24-27) [NOTE: In response to MPC Data Request 316, Mr. Clark recalculated the net adjustment to be $1,340,325 based solely on balancing with non-firm purchases.]

126. Mr. Clark proposed that any adjustment resulting from the RSA be reflected from the time of the interim revenue requirement impact. [July 17, 1991]

MPC Rebuttal and Supplemental Testimony

127. On June 19, 1992, MPC filed prefiled rebuttal testimony from Mr. Pascoe and additional supplemental testimony from Mr. Cole. Mr. Pascoe maintained that the unanticipated impact of the RSA on the 1989-90 and 1990-91 ICP FOR should not result in an adjustment to the test year revenue requirement as proposed by Mr. Clark. (Exh. MPC-8, p. 1 and 6)

128. Mr. Pascoe believed that the correct FOR amount to be used in the test year was 181 MW, which came from the 1990-91 ICP study results, adjusted for the 19 MW swing. Mr. Pascoe

testified that the 1990-91 study was received in November, 1990, less than 12 months after the end of the test year. Mr. Pascoe noted that 181 MW is essentially equal to the FOR obligation (182 MW) that was used earlier in this Docket (Exhibit (RJL-7)). Therefore, Mr. Pascoe rebutted Mr. Clark's claim that the RSA resulted in excessive reserves being included in the test year. Mr. Pascoe maintained that Mr. Clark's proposed adjustment to the revenue requirement was unwarranted. (Exh. MPC-8, pp. 2-6)

129. Mr. Pascoe provided a calculation to value the 19 MWs if the Commission determined that an adjustment was appropriate. Mr. Pascoe maintained that the magnitude of the adjustment proposed by Mr. Clark was clearly unreasonable. The value Mr. Pascoe arrived at for the 19 MWs was $151,449. Mr. Pascoe maintained that:

> this calculation properly reflects the PacifiCorp and WWP sales revenues which largely offset the cost of the Idaho purchase, and bases the adjustment on the residual capacity cost. This is appropriate since reserves are based on capacity requirements and not on energy needs. (Exh. MPC-8, p. 11)

Mr. Pascoe believed that his calculation was consistent with prior Commission findings regarding the Idaho purchase. (Exh. MPC-8, pp. 7-11)

130. Mr. Pascoe stated that his position throughout has been that generation normalization was appropriately included in the test period. (Exh. MPC-8, p. 12)

131. Mr. Pascoe disputed Mr. Clark's statement that the RSA was a result of the contracts with LA and Puget and was not required by the Project Agreements. Mr. Pascoe acknowledged that the RSA was not needed prior to the LA and Puget contracts because Colstrip 4 was being dispatched as part of the Utility Division's system. He stated however, that "in order to separate Colstrip 4 from the Utility Division's resources so that CS4LMD could enter into long term sales arrangements without involving the Utility Division's other resources, the RSA was needed to comply with the Project Agreements." (Exh. MPC-8, p. 15 and 16)

132. Although MPC did not agree with Mr. Clark's adjustments to the life cycle analysis, Mr. Cole stated that MPC does agree

with MCC's final conclusions that (1) Colstrip 3's remaining costs are lower than Colstrip 4's; and (2) Colstrip 4 costs should not be reallocated in some way to MPC's customers. (Exh. MPC-9, pp. 3-7)

133. The hearing for the RSA issue was held July 15, 1992.

COMMISSION DECISION

134. The Commission reviewed the ratemaking impacts of the RSA. Mr. Pascoe testified that MPC will continue to benefit from the RSA due to the reduction of approximately 3 MW in the FOR. (Exh. MPC-7, pp. 7 and 8) MCC testified that the RSA has the potential to benefit the ratepayers through the FOR reduction, but maintains that ratepayers are not presently receiving this benefit due to the overstatement in the test year of the FOR by the ICP. MCC has agreed that the 3 MW reduction has been assigned to MPC. (Exh. MCC-3, p. 25) The Commission accepts the testimony regarding the 3 MW FOR reduction and finds that it benefits the Utility and the ratepayers. The Commission discusses the overstatement of the FOR in findings 137 to 143. The Commission recognizes that the RSA also benefited the CS4LMD through the presumed value that the RSA had to LA and Puget during the contract negotiations.

Life Cycle Analysis

135. The Commission shares Mr. Clark's perception that different results may be produced if the analysis was conducted over the life of the units rather than from 1991 forward. Nonetheless, the Commission required MPC to analyze from 1991 forward, and MPC has provided such analysis.

136. Both MPC and MCC arrive at the same conclusion that the remaining costs of Colstrip 4 exceed those of Colstrip 3. MPC recommended using a levelized revenue requirement. (Exh. MPC-9, p. 6) MCC advocated an accumulated net present value approach. (Exh. MCC-3, p. 17) The Commission recognizes that regardless of the method used, the outcome is the same. The Commission finds that for purposes of examining the RSA, the remaining costs of Colstrip 4 exceed those of Colstrip 3. Furthermore, both parties recommended that Colstrip 4 costs not be reallocated to the Montana ratepayers. (Exhs. MCC-3, pp. 12 and 19; MPC-9, p. 4) The Commission agrees with this recommendation and finds that

rates will continue to exclude all costs associated with Colstrip 4.

Review of the FOR

137. The RSA issue is a reserved issue from this Docket dating back to June, 1990. There is no precedent in previous dockets for updating the Loads and Resources to include ICP studies that are received after the original filing. Mr. Pascoe testified that the 1989-90 ICP study, not the 1990-91 study, was used in Docket 90.6.39. (Exh. MPC-8, p. 4) The Commission finds that the 1989-90 ICP study is the appropriate ICP study to be used in the reserved RSA issue.

138. Mr. Pascoe also indicated that he generally accepted Mr. Clark's assertion that the 1989-90 ICP study overstated MPC's reserve obligation by 19 MWs as a result of the RSA, based on dual studies done with and without the RSA by the ICP for years 1990-91 and 1991-92. (Exh. MPC-8, pp. 4 and 5) The Commission determines that it will reduce MPC's revenue requirement to recognize that current rates are overstated because of the excessive FOR included in rates. The Commission finds that the FOR is overstated by 19 MWs.

139. Mr. Clark's proposed adjustment of $1,340,325 is based on the cost of 19 MW of the Idaho purchase offset by the price of non-firm purchases which MPC has made. Mr. Pascoe disputed this method, stating that Mr. Clark's proposal would remove a portion of the expenses for the Idaho purchase from the test year without removing any of the revenues from the sales to PacifiCorp and Washington Water Power. (Exh. MPC-8, pp. 9 and 10) Mr. Pascoe referred to the response to HRC Data Request No. 1 which demonstrated that the net cost of the Idaho purchase was $478,260, and that the net amount of winter capacity resulting from the Idaho purchase was 60 MW. Mr. Pascoe proposed to divide the net cost of the Idaho purchase, $478,260, by 60 MW to derive the net cost of $7,971 per MW of winter capacity. He then multiplied this figure by the 19 MW adjustment recommended by Mr. Clark which resulted in $151,449. (Exh. MPC-8, p. 11)

140. The Commission has previously reviewed the Idaho purchase. In Order 5484p, FOF 46, the Commission stated:

> In Order No. 5484k the Commission found that

> the IP purchase was needed to serve peak loads in the test year. There is no evidence to the contrary on this record. As to the energy association with the IP purchase, the Commission finds that all of the energy was sold at firm off-system prices to Washington Water Power and Pacificorp. The response to HRC Data Request No. 1 indicates that the net cost of the IP purchase is $478,260 after reflecting the sales to WWP and PacifiCorp. If MCC's revised adjustment were accepted, the net effect of the Idaho purchase would be a decrease in MPC's revenue requirement of $2,234,137 ($478,260 - $2,712,397), which is an unreasonable outcome.

141. The Commission faces a similar situation with the RSA issue. Mr. Clark proposed an adjustment of $1,340,325 while the net cost of the Idaho purchase has already been determined to be $478,260. Accepting MCC's adjustment would again produce an unreasonable outcome. The Commission finds that MPC's calculation is appropriate and values the 19 MWs at $151,449.

142. The Commission finds that the administrative costs to pass the $151,449 back to the ratepayers at this time outweigh the intergenerational equity benefits. The Commission finds that in its next general rate case MPC shall reflect the total revenue impacts of the $151,449 annual expense overstatement that is currently included in rates. This amount shall include interest at 12.1 percent and be calculated from the date that the final order was issued granting interim treatment to the RSA issue (July 17, 1991). These amounts shall be reflected in any interim rate request that MPC may propose.

143. As a result of reviewing the RSA and its effect on the FOR requirement, the Commission observed year-to-year fluctuations in the level of the FOR. MPC shall in its next general rate case provide adequate information as to the reason for the fluctuations in the FOR requirement from the 1988-89 year forward.

Generation Normalization

144. In this Docket, test year generation for Colstrip 3 was normalized using conventions set forth in the RSA, that is, output from both Colstrip 3 and 4 are considered in the calculation. In FOF 206, Order No. 5484k, the Commission

determined that the $650,000 benefit identified by MPC would be included in rates on an interim basis. Both MPC and MCC agree that the effect of the RSA on the generation normalization calculation is $650,000. The Commission finds that the interim treatment afforded the $650,000 now be made final.

CONCLUSIONS OF LAW

1. Montana Power Company furnishes electric service for consumers in the State of Montana, and is a public utility subject to the regulatory jurisdiction of the Montana Public Service Commission pursuant to Title 69, Chapter 3, Montana Code Annotated (MCA). §§ 69-3-101 and 69-3-102, MCA.

2. The Montana Public Service Commission properly exercises jurisdiction over Montana Power Company's rates and operations. § 69-3-102, MCA.

3. The Montana Public Service Commission has provided adequate public notice of all proceedings and an opportunity to be heard in this Docket. §§ 69-3-303, 69-3-104, MCA, and Title 2, Chapter 4, MCA.

4. The Montana Public Service Commission concludes, as a matter of law, that the reserved issues in this Docket, after full consideration in this separate proceeding, will have no additional impact on the revenue requirement established in previous orders in this Docket, with the consideration of the $151,449 annual expense overstatement of the forced outage reserve requirement as described in this order to be reflected in MPC's next rate case.

5. The Montana Public Service Commission concludes, as a matter of law, that the Utility Division of the MPC was adequately compensated in the FOG wire transaction with its affiliate, Telecommunications Resources, Inc. (TRI).

ORDER

Wherefore, the Montana Public Service Commission issues the following order:

1. The revenue requirement established in previous orders in this Docket shall remain unchanged until Applicant's next rate case proceeding, in which the $151,449 annual expense overstatement of the forced outage reserve requirement will be reflected at 12.1 percent interest calculated from July 17, 1991,

date of issuance of Order No. 5484k.

2. Applicant MPC, the Utility, in affiliate transactions shall maintain scrupulous records and keep documentation at the highest level of conscientiousness so as not to thwart the Commission's scrutiny in audits, investigations and future rate case proceedings.

3. The Commission deems that MPC received adequate compensation for its electric ratepayers in the fiber optical ground wire (FOG wire) transaction with its affiliate Telecommunications Resources, Inc. (TRI), in the amount of $2.3 million.

4. MPC shall, as part of the next rate application, provide information and documentation on the rationale for the fluctuations in the forced outage reserve requirement for the years 1988-89, forward.

Done and Dated this 10th day of December, 1992, by a vote of 4-1.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

DANNY OBERG, Chairman
WALLACE W. "WALLY" MERCER, Vice Chairman
TED C. MACY, Commissioner
BOB ANDERSON, Commissioner
(Concurring and Dissenting, Written Opinion to Follow)
JOHN B. DRISCOLL, Commissioner
(Dissenting, Written Dissent Attached)

ATTEST:

Kathlene M. Anderson
Commission Secretary

(SEAL)

NOTE: Any interested party may request that the Commission reconsider this decision. A motion to reconsider must be filed within ten (10) days. See ARM 38.2.4806.

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December 12, 1992

Docket 90.6.39 (Reserved Issues)

Dissent
Commissioner Driscoll
Related Dissent:90.6.39

I have six major reasons for dissenting from this Order. Any one of these reasons makes the Order unacceptable. I will leave out the many difficulties, that could be characterized as only differences of opinion, or legitimately protected by the Proprietary Order in this matter.

The six failings are:

1. Proprietary information safeguards are being used to shield information about self dealing between a regulated utility and its affiliate from the Public, effectively neutralizing

Montanans' rights to open government;

2. The Used and Useful statute is being ignored;

˝

3. The FOG wire portion of the decision is arbitrary, because it is driven by a predetermined result desired by the Commission's majority, rather than by the record and state statute;

4. The Reciprocal Sharing Agreement between Montana Power" rate based Colstrip 3 and Montana Power's "independent" Colstrip #4 is not critically enough evaluated;

5. The apparent shift of the 31 NW reserve requirement of Colstrip 4 to and increased 31 MW of reserve requirements for the rate based system has continued to be papered over; and

6. Instead of using these two major affiliate transaction issues to set predictable policy against self dealing, between the utility and its affiliates, this Order simply muddles disconnectedly toward one unifying conclusion: no change in existing revenue requirement.

In may judgment it would have been far better to defer these issues indefinitely, with the same neutral effect on revenues, than to create an order in this case that may prove a troublesome precedent for more conscientious future Commissions.

1. ABUSE OF PROPRIETARY INFORMATION SAFEGUARDS:

As Commission policy stands now, a utility or affiliate only has to ALLEGE that certain information is proprietary. All Commissioners and Staff have to sign statement that they will not disclose such information. Unless someone challenges and proves the information is not proprietary, the ALLEGATION rules.

Consequently, if I, or another Commissioner sign the proprietary order, we can't talk. If we don't sign the order, then we are obstructing the smooth work flow at the Commission...if in a majority, and excluded from the case, if in a minority. Everyone outside of the closed information circle, including the Press, has no idea what they are missing; if they are inside, they can't talk to those outside. This is a huge loophole to violate the public information protections of Montana law. I am convinced it must be challenged at every turn...particularly by the Press.

As with most Montanans, my signature and my work are everything to me. Just as I have signed an agreement in this case to protect proprietary information, I asked Montanans to let me be a utility Commissioner on the promise that ratepayers would be treated fairly. From the horns of this dilemma, I have tried in the first drafts of this Dissent to give only approximate numbers to convey an idea of what is considered proprietary in this case, by filling in close numbers for the blank figures (that the Public only sees) in Finding #20. However, the Commission Staff, properly doing their job, advises me that the Dissent cannot be distributed as part of the this Commission Order, because my numbers were to thinly veiled and would expose the Commission to charges of violating its own Protective Order. I conclude that only an indignant Public in Montana can break the Catch 22 we have going in this matter.

Finding #20, as a watered down example, restates Montana Consumer Council expert testimony:

"20. Mr. Buckalew stated that in consideration for the installation, operation and maintenance of this system AT&T agreed to pay TRI approximately ($**,***,***) initially, plus about ($***,***) annually. Total construction costs were about ($**,***,***) annually. Total construction costs were about ($**,***,***) leaving gross initial profits of about ($**,***,***). Those profits were divided between TRI, Alcoa (who supplied the aluminum clad FOG wire) and an individual (John Warta) who was apparently involved in putting the deal together. TRI also agreed to pay MPC a one time pole attachment fee of %472,694 (net of pole construction cost reimbursement) plus the lesser of $57,854 or 20 percent of the annual O&M costs of the associated transmission line facilities. Mr. Buckalew stated:

> It is very clear that MPC has used TRI as an unregulated "vehicle" in which to realize and record a large profit windfall in excess of the Company's cost of capital and authorized rate of return. Apparently, MPC intends to retain this windfall for its stockholders rather than using the proceeds to provide traditional revenue offsets for its utility ratepayers. (EXh. MCC-1 pp. 5-6)

Is the non disclosure of the obscured numbers a trade secret that must be kept to protect TRI against possible competitors? I have concluded that much of what is alleged to be proprietary is being kept secret to shield Montana's telephone and electric utilities' highly profitable misuse of rate payer supported assets. Without the rate payer supported utility right of way and transmission structures, this project would have been impossible; the advance of telecommunications technology has, in other words, created a "hidden asset", which MPC handed off to its affiliate. The Press needs to bring this matter under public scrutiny, and force the Commission to a different option. Proprietary procedural orders are commonplace now; they should be rarely invoked, and then only after the requestor has proven specific need based upon a record of evidence.

The potential for abuse of proprietary information safe-guards by Montana's regulated utilities, is my greatest concern as I end my twelve years on the Montana Public Service Commission. I cannot be more direct.

2. IGNORING THE USED AND USEFUL STATUTE:

The utility and Commission go the great pains in this cases to show that the 48 microwave channels, bartered by TRI to MPC, are valuable enough additional compensation. The tortuous attempts at proving their value are a waste of time, since only 2 are actually being used.

It is a easy enough matter to recognize the then current value of the other 46 channels, in future cases, if and when they actually have a purpose. This is what the used and useful statue is all about, at the rate telecommunication is changing, the same capacity might be leased for far less that even the lowest current estimate of their value. The important consideration here, however, is that everyone has conveniently forgotten an important statutory requirement laid on this Commission by the Legislature. The telecommunication must be used and useful. Right now, the unused channels relied upon in large part by the Commission to justify this transaction, are UNUSED.

A further complication, of course, is that the gas side of the utility is the rate base that is experiencing the advantage of the 2 microwave channels that are used and useful (Finding 48). "Other service needs" are being transferred to the micro-wave channels, thereby freeing up the MPC analog communications system to be absorbed by the GAS UTILITY. This order is about adjusting rates on the ELECTRIC UTILITY side. Even if there were no used and useful statute, the bartered value of the 48 channels shouldn't be used as a substitute for cold hard cash to offset ELECTRIC UTILITY rates.

3. ARBITRARY NATURE OF FOR WIRE DECISION:

At the time, it was mystery to me how it happened. Somehow, at the midpoint of the key deliberations on the FOG wire portion of this case, a majority of tree Commissioners came to the same conclusion. The work session happened on parts of September 21 and September 22. The only motion in this portion of the case happened suddenly on the second day September 22. Commissioner Macy was absent. Commissioner Oberg handed the Chair to Commissioner Mercer, and moved to "direct staff to draft an order that requires no adjustment to current rates and finds MPC has been reasonably compensated for the FOG Wire project." The original motion in Commissioner Oberg's personal handwriting is attached (A). Commissioner Mercer returned the Chair to Commissioner Oberg, and seconded the motion. Commissioner Oberg then held up a Proxy vote in favor of his motion from Commissioner Macy. The minutes of this publicly noticed meeting show 3 voting yes; 2 voting no (Driscoll and Anderson). At the time it was unclear to me how Commissioner Macy knew the motion in advance, and that it would be seconded. I have since acquired copies of communications between Commissioner Oberg and all of the Commissioners (including apparently myself) (B), and between Commissioner Macy and Commissioner Oberg (C). At the time of the meeting I had not seen or read the first, and was not privy to the second. There would have been no sense even going to the meeting, let alone staying awake the previous night, trying to devise a set of guideline for affiliated transactions. A quorum had already decided the outcome of the matter before the Commission. Given the attached correspondence, on wonders if the Open Meeting Law is being violated by this kind of practice.

I am now more concerned with the broad and arbitrary nature of the motion itself.

The motion appears to me to be result oriented, rather than a result ensuing from a long series of motion on record based fact and expert testimony. The order, based upon this single motion, leaves the impression that the Commission worked through these matters, leading up to a conclusion, but this is not the case. The commission discussed many of these matters, but left the Staff to string them together (massage the numbers?) so as to reach the desired result. This is a significant departure from practice. I refuse to condone it.

4. RSA EVALUATION NOT THOROUGH ENOUGH:

The Reciprocal Sharing Agreement (RSA) with Montana Power's so called "independent" affiliate, Colstrip #4 Lease Management Division (CS4LMD), for certain reciprocal arrangements between Colstrip #3 and Colstrip #4 is an extremely serious matter. I fully agree with Montana Consumer Council witness, Al Clark, that this matter should be reserved for a separate Docket.

The company argued that, because of RSA, ratepayers had the advantage of covering Colstrip #3's lesser performance (lower capacity factor), with Colstrip #4's better performance (better capacity factor) to this point in its history. When asked why the "independent" twin was running more often than its rate based sister plant, the answer was "coincidence" (Transcript: p.221) When asked if it put a bigger reserve requirementon the rate based utility, MPC told the Commission that the Forced Outage Reserve actually dropped 3 MW from greater "diversity". The fact that the tiny "drop" was computed from a much higher base Forced Outage Reserve requirement was eluded by the utility, and not confronted by the Commission (Finding 143).

I believe this Order papers over a very bad deal for Montana ratepayers. It seems to me that Colstrip #4 is running more often because it has priority. Will truly Exempt Wholesale Generators, under the new 1992 Energy Policy Act, have similar treatment by MPC system dispatchers, and similar access to constrained transmission lines? I doubt as much. Consequently, will this RSA order be used as a regulatory shield to protect Montana Power's favored treatment of the "independent" Colstrip #4 from inevitable anti-trust action?

5. CS4LMD'S SHIFT OF RESERVE REQUIREMENT (31MW) TO RATE BASE:

With regard to Forced Outage Reserve, its clear that Colstrip #4 is expected to have the same associated reserve requirement as its sister plant (31 MW). CS4LMD accommodated such a reserve internally until the LA and Puget Sales. Then, in the same year that CS4LMD committed MORE than its entire output from Colstrip #4 to long term firm markets, the 31 MW Forced Outage Reserve disappeared from CS4LMD's internal allocation. Not so strangely, 31 MW appeared as a new additional reserve requirement for the regulated part of Montana Power. Looking back through the forecasts of loads and resources for the years just previous, no increase in reserve requirement had been predicted. The touted minor savings (3 MW) associated with the RSA, was calculated and subtracted from the higher base that included the new 31 MW reserve requirement of Colstrip #4.

Will any new Independent Power Producer or Exempt Wholesale Generator be able to sell more than the entire output of its plant, and then satisfy the regional reliability standards of the Western Systems Coordination Council, by having the ratepayers of Montana Power pay the millions needed to install associated reserves? Likely not! There is much discussion of the Forced Outage Reserve question in this order, but it is not on point. The matter needs serious attention.

If one subtracts from Colstrip #3 the amount of firm power (213 MW) that CS4LMD sold off system in excess of Colstrip #4's MPC production capability (210 MW, it both plants are nominally 700 MW), the rated production capability of Colstrip #3 available to service load is less by 3 MW (207 MW). Subtract, then, the Forced Outage Reserve Requirement of both Colstrip #3 and #4 (62 MW) now saddling Colstrip #3 because of the Reciprocal Sharing Agreement, them apply the lower capacity factor, because of Colstrip #3's mysteriously poorer performance. One begins to wonder if Colstrip #3 is a good deal for the ratepayer, if this Commission is not going to really trace and offset the consequences of the Reciprocal Sharing Agreement. If we add the operating costs of a possible carbon tax, Colstrip #3 may be a very expensive plant for the Montana ratepayer to be relying upon, per kwhr of production. The RSA is an "externality" that is hobbling the Colstrip #3 plant's real performance for the rate payer. This particular externality should be included in any matching of new with existing resource efficiency. The RSA is creating a tremendous hidden operating burden, as long as this Commission refuses to confront how the "independent" Colstrip #4 is treating Colstrip #3 as a "hidden asset".

This Commission has thus far satisfied itself with circular reasoning in response to this concern. The argument that CS4LMD could sell more than its entire portion of Colstrip #4 off system (including 31 MW of reserve) to LA and Puget, because they "picked up the reserve requirement", is only partial. The unit commitment contracts rely on the existence of Reciprocal Sharing Agreements with Colstrip #3, thereby diversifying risk to Colstrip #3. Colstrip #3, in turn diversifies its risk to the rest of the integrated ratepayer supported system, by having 31 MW suddenly appear as an additional reserve requirement to the utility. It should be absolutely clear that there is no reason for the utility to sign a Reciprocal sharing Agreement with an "independent". The integrated utility system is already designed to diversify risk, and the ratepayers have assumed the underlying cost of necessary Forced Outage Reserves. Colstrip #4 is the single plant that is hanging out there by itself, that can't meet the reliability standards of the Western System Coordinating Council (not Intercompany Pool, by the way), if it sells more than its total rated output to a firm customer. The commission is like the friend Tom Sawyer talked into whitewashing the fence, if the friend paid an apple core. This is another whitewash job, but the cost to ratepayers is much greater than an apple core.

6. THE FAILURE TO ESTABLISH POLICY AGAINST SELF DEALING:

It had been my hope that the Commission would at least use these reserved issues to set clearly established policy for the company to follow, to avoid such obvious self dealing in future affiliate transactions. We need to encourage managers to find ways to use all of the assets of the utility and its affiliate more efficiently and more profitably. This means that the opportunity to make lots of money has to be out there, but certainly not at the risk of giving the ratepayer less than what is deserved. Its no challenge, and, even for the good hearted utility executive (of which I believe there are many at Montana Power Company), its less quandry, at all to pillage the trusting and unprotected innocent in this rapidly changing technological world. Though it pains me to say it, I certainly see no cause for Montana Power's Board and Management to be bragging about the performance of the two "unregulated" affiliates under review. On the other hand, we shouldn't expect even well meaning utility managers to avoid stepping over the line, if the Commission will not indicate where the line is Ultimately, this problem is a failure of regulation by the Montana Public Service Commission.

Generally, I believe that once a decision is made by the upper management of a consolidated corporation to commit its regulated utility in an affiliate transaction, a number of general practices should follow:

1. Fair and equitable effort should be directed at valuing the newly revealed qualities of utility asset being used or bought;

2. The risk associated with the venture, allocated to the utility, should be limited to reflect normal levels of utility risk;

3. The compensation to the utility side should be at the new asset value, or according to a utility rate of return on that value:

4. The compensation to the affiliate side (regardless of the combination of affiliates) should be for taking the higher residual levels of risk;

5. Compensation for management creativity should be split evenly between utility and affiliate profit centers, because it takes a substantial creativity and stewardship on both ends to to do this right;

6. The net revenues being allocated between the utility and affiliate should be those net of costs outside the consolidated corporation;

7. "Outside costs" designed mainly to shift risk away from the consolidated corporation, would come from the revenue allocation to the affiliate in its role as the residual risk taker;

8. The plan, once ready, should be presented to the Commission for its expedited review, with proprietary protection, only if a need can be demonstrated.

At the Staff level, the Montana Commission has already developed some minimum filing standards, affiliated interest transaction guidelines, and periodic reporting requirements that could further streamline an expedited review process, eliminate confusion, and help insure that the Commission remains on top of these matters. An early Staff draft of minimum filing requirements gives an idea of how the Commission should have approached the two affiliate transactions covered in this Order:

1. Transactions Summary--The utility shall identify and explain thoroughly all the transactions which have occurred between it and affiliated entities since its last filing under the Minimum Rate Case Filing Standards.

2. Procedures and Internal controls--The utility shall identify and explain thoroughly any business opportunities that have been transferred between it and affiliated entities.

3. Transfer of Business Opportunities--The utility shall identify and explain thoroughly any business opportunities that have been transferred between it and affiliated entities.

4. Financial Impacts--The utility shall identify and explain thoroughly the impacts that the business activities of affiliated entities have on the utility capital structure, cost of capital, corporate structure and future business and financing plans.

5. Affiliate Synergies--The utility shall identify and explain thoroughly any market or proprietary information or other research and development which is shares between it and affiliated entities, the involvement of high-level management in formulating business strategies or in executing business decisions for the utility and affiliated entities, the handling of employee sharing and employee transfers between the utility and affiliated entities and any other cooperative efforts which have existed between the utility and affiliated entities.

6. Transfer Pricing--The utility shall identify any remuneration between the utility and affiliated entities for goods and services, tangible or intangible. The basis for such remunera-

tions shall be explained thoroughly.

I think, generally, it would be the commission's role to clearly state its concerns up front, set a floor on expected income form the venture, and a ceiling on permissible risk. Each transaction must be case specific. The utility's portion of earning from each venture will be low risk and asset based; the affiliates' will be higher risked and niche based. Knowing these parameters, the Company can then choose whether or not to proceed. I believe the overall risk of project failure will be less, and the chance of profitable success for both utility and affiliate, as well as ratepayer and stockholder, will improve.

CONCLUSION:

This is a bad order. I think it would be wise for all parties concerned to ask for a rehearing in front of the next Commission. In the process, affiliated transaction policy could be established, and policy with regard to Exempt Wholesale Generators, Independent Power Producers, and Federal Energy Regulatory Commission mandated transmission access could start to evolve

Attached: A. Chairman Oberg's handwritten minute entry of the Commission's only direction to Staff in the FOG Wire matter.
B. Chairman Oberg's handwritten note to commissioners (not Staff), regarding his plan for the second half of the work session.
C. Commissioner Macy's handwritten vote to Chairman Oberg.

Respectfully,

Commissioner John B. Driscoll

Department of Public Service Regulation
Before the Public Service Commission
of the State of Montana

* * * * *

In the matter of the application	)	Utility Division
by the Montana Power Company	)	

for authority to increase rates for) Docket No. 90.6.39
natural gas and electric service)

Dissent of

Commissioner Bob Anderson

On Order No. 5484z

Order 5484z is the Commission's final order on reserved issues, including the Fiber Optic Ground (FOG) Wire. The Commission found that the Montana Power Company (MPC) was adequately compensated by its affiliate Telecommunications Resources Inc. (TRI) for the project. Implicit is that the utility was reasonable in its decision not to take on the project itself and allow TRI to do it. The reasonableness of MPC's decision not to accept the risk of doing the project itself is questionable because: in hindsight, the risk of the project was grossly overestimated; no overall economic analysis of the project was performed; the decision was poorly documented; both the utility and TRI were advised by the same counsel; and the project turned out to be extremely lucrative for MPC shareholders, through TRI. I disagree that the utility was adequately compensated.

Adequacy of compensation can be based on the profitability of the project or on the value of the asset used (the transmission system).

Profitability

Profits can result from one or more of several factors, including: investment, risk taking, selling an asset, performance (e.g. creativity, opportunism, aggressiveness, competence, management skill, marketing, hard work), knowledge, or business relationships. What did TRI have in the case of the FOG wire project that resulted in the large profit? It took very little risk and it made little or no investment (which under cross examination and in a late-filed exhibit it did not quantify). It did perform impressively; it exhibited vision, opportunism, good management, and aggressiveness. However, it benefitted greatly from knowledge and business relationships due to its affiliate relationship with the utility. Therefore, there should be a fair sharing of the profits between TRI (MPC shareholders) and the utility (MPC ratepayers). TRI's profits are confidential under the terms of a protective order.

Value of the asset

At paragraph 63., the Commission found that, using an FCC method, adequate compensation for the project is $2.33 million.

The utility asserted that it received compensation as follows:

pole rental fee		$600,000
maintenance expense	480,000	
48 microwave channels	2,000,000	
transmission inspection	250,000	
Total		$3,330,000

Pole attachment fee. MPC stated it received $600,000. However, MPC paid $127,305 in transmission improvements; TRI also paid $127,305 for transmission improvements. Because these improvements would not have been made in the test year (or in the 12 following months), compensation was actually $472,695 ($600,000 less MPC's expense).

Maintenance expense. MPC claimed it will receive the lesser of 20% of its annual O&M expense or $57,854, which has a present value of $480,000. However, this is not actually compensation, because the payment will only be made if actual work is done, in which case it would be part of the normal revenue requirement and compensated through rates determined in a rate case.

48 microwave channels. Only two of the 48 channels are currently in use. Therefore, only 2/48ths, or $83,333 should be considered compensation. If additional channels are used in the future, resulting in the deferral of the construction of a new system, then a general rate case can take that into account.

Transmission inspection. Regardless of the claimed value of this inspection, it was not needed in the test year. Therefore it should not be counted as compensation for this project.

Summary: compensation. Compensation actually received was $472,695 for the pole attachment fee and $83,333 for the microwave channels, totalling $556,028. This is less than the $2.33 million considered by the Commission to be adequate by $1,773,971. The revenue requirement should be reduced at least by this amount.

Sharing.

Utilities have valuable assets paid for by ratepayers. The value of these assets can be increased, as in the case of the FOG wire project. The utility should have an incentive to add value to its assets. A proper incentive would be the sharing of profits of such a venture, above a reasonable lower limit based on the existing value of the asset, between shareholders and ratepayers. In this case, any profits above $2.33 million should be shared, perhaps on a 50/50 basis.

Affiliate relationships.

In situations in which a regulated utility and its unregulated affiliate do business, there should be record keeping to remove any doubt about the reasonableness of the terms to avoid any doubt about shifting of risk and/or costs from shareholders to ratepayers. In the FOG wire case, records were extremely poor. Both the utility and TRI were advised by the same counsel. An economic and risk analysis was either not done by the utility or it was not documented. In the absence of such documentation, the utility fails its burden of proof that the transaction was fair and reasonable.

Bob Anderson, Commissioner